

104  
**HEALTH INSURANCE DEDUCTIBILITY FOR SELF-  
EMPLOYED INDIVIDUALS**

---

Y 4.5M 1:104-4

Health Insurance Deductibility for...

**HEARING**  
BEFORE THE  
**COMMITTEE ON SMALL BUSINESS**  
**HOUSE OF REPRESENTATIVES**  
ONE HUNDRED FOURTH CONGRESS  
FIRST SESSION

---

WASHINGTON, DC, JANUARY 20, 1995

---

Printed for the use of the Committee on Small Business

**Serial No. 104-4**



U.S. GOVERNMENT PRINTING OFFICE

87-344 CC

WASHINGTON : 1995

---

For sale by the U.S. Government Printing Office  
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402  
ISBN 0-16-047327-6



104  
**HEALTH INSURANCE DEDUCTIBILITY FOR SELF-  
EMPLOYED INDIVIDUALS**

---

Y 4.5M 1:104-4

Health Insurance Deductibility for...

**HEARING**  
BEFORE THE  
**COMMITTEE ON SMALL BUSINESS**  
**HOUSE OF REPRESENTATIVES**  
ONE HUNDRED FOURTH CONGRESS  
FIRST SESSION

WASHINGTON, DC, JANUARY 20, 1995

Printed for the use of the Committee on Small Business

**Serial No. 104-4**



U.S. GOVERNMENT PRINTING OFFICE

87-344 CC

WASHINGTON : 1995

---

For sale by the U.S. Government Printing Office  
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402  
ISBN 0-16-047327-6

## COMMITTEE ON SMALL BUSINESS

JAN MEYERS, Kansas, *Chair*

JOEL HEFLEY, Colorado  
WILLIAM H. ZELIFF, JR., New Hampshire  
JAMES M. TALENT, Missouri  
DONALD A. MANZULLO, Illinois  
PETER G. TORKILDSEN, Massachusetts  
ROSCOE G. BARTLETT, Maryland  
LINDA SMITH, Washington  
FRANK A. LOBIONDO, New Jersey  
ZACH WAMP, Tennessee  
SUE W. KELLY, New York  
DICK CHRYSLER, Michigan  
JAMES B. LONGLEY, JR., Maine  
WALTER B. JONES, JR., North Carolina  
MATT SALMON, Arizona  
VAN HILLEARY, Tennessee  
MARK E. SOUDER, Indiana  
SAM BROWNBCK, Kansas  
STEVEN J. CHABOT, Ohio  
SUE MYRICK, North Carolina  
DAVID FUNDERBURK, North Carolina  
JACK METCALF, Washington

JOHN J. LaFALCE, New York  
RON WYDEN, Oregon  
NORMAN SISISKY, Virginia  
KWEISI MFUME, Maryland  
FLOYD H. FLAKE, New York  
GLENN POSHARD, Illinois  
EVA M. CLAYTON, North Carolina  
MARTIN T. MEEHAN, Massachusetts  
NYDIA M. VELAZQUEZ, New York  
CLEO FIELDS, Louisiana  
WALTER R. TUCKER III, California  
EARL F. HILLIARD, Alabama  
DOUGLAS "PETE" PETERSON, Florida  
BENNIE G. THOMPSON, Mississippi  
CHAKA FATTAH, Pennsylvania  
KEN BENTSEN, Texas  
KAREN MCCARTHY, Missouri  
WILLIAM P. LUTHER, Minnesota  
PATRICK J. KENNEDY, Rhode Island

JENIFER LOON, *Staff Director*

JEANNE M. ROSLANOWICK, *Minority Staff Director*

# CONTENTS

---

Hearing held on January 20, 1995 .....	Page 1
--	-----------

## WITNESSES

FRIDAY, JANUARY 20, 1995

Enmeier, Richard, the Marrick Company, Indianapolis, Indiana, National Association of the Self-Employed .....	6
Morrisette, Jeanie, Homestead Construction Company, Inc., Annandale, Virginia, National Association of the Remodeling Industry .....	3
Sprague, Lisa, Manager of Employee Benefits, Small Business Center, U.S. Chamber of Commerce .....	10
Stehman, Betty, Entrepreneurial Financial Services, Inc., Silver Spring, Maryland, National Association of Home-based Businesses .....	2
Willett, Craig, Willett and Associates, Provo, Utah, National Federation of Independent Business .....	7

## APPENDIX

Opening statements:	
Clayton, Hon. Eva M .....	19
LaFalce, Hon. John J .....	20
Meyers, Hon. Jan .....	21
Prepared statements:	
Enmeier, Richard .....	23
Morrisette, Jeanie .....	28
Sprague, Lisa .....	34
Stehman, Betty .....	37
Willett, Craig .....	41
Additional material:	
American Institution of Certified Public Accountants .....	49



# HEALTH INSURANCE DEDUCTIBILITY FOR SELF-EMPLOYED INDIVIDUALS

FRIDAY, JANUARY 20, 1995

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON SMALL BUSINESS,  
*Washington, DC.*

The committee met, pursuant to notice, at 10:05 a.m., in room 2359-A, Rayburn House Office Building, Hon. Jan Meyers (chairwoman of the committee) presiding.

Chairwoman MEYERS. Good morning, ladies and gentlemen. Our hearing this morning is the fourth in our series of hearings devoted to tax policy and small business. This morning we will focus on the health insurance tax deductibility for self-employed individuals.

At this time I would like to ask unanimous consent to enter into the record the testimony of Representative Earl Pomeroy. He is not a member of this committee, but he does have a bill in on this, as I do, and another Member or two. But Mr. Pomeroy has asked to have his statement submitted for the record, without objection.

[Mr. Pomeroy's statement may be found in the appendix.]

Chairwoman MEYERS. The 25 percent health insurance tax deduction was enacted by Congress in the Tax Reform Act of 1986 and extended in the Tax Extension Act of 1991 through June 30, 1992, and extended again for an additional 1 year in the Omnibus Budget Reconciliation Act of 1993 from July 1, 1992, to December 31, 1993.

I think you can tell from that chronology that the 25 percent health deduction has been extremely important for small business people. By only extending the deduction 1 year at a time, we have not allowed small business people to plan as they should have been able to, and this last year we pulled the rug out from under them completely.

Since we had extended it a year at a time every year since 1986, many small business people went ahead, provided health care insurance for their employees, and then we did not renew. I have a bill making the deduction retroactive. I think Mr. Pomeroy's bill also makes it retroactive. I go on to make it permanent and Mr. Pomeroy goes on to extend it to 100 percent. I also intend to incrementally increase it to 100 percent, and, as I said, there may be some other bills in that I am not aware of.

For purposes of the 25 percent tax deduction, self-employed individuals include sole proprietors, working partners, and employees of an S corporation who own more than 2 percent of the corporation's stock. No deduction is permitted if the self-employed individual is eligible to participate on a subsidized basis in a health plan

of an employer of the self-employed individual or individual's spouse.

I believe the figure that I have used in the past is that this 25 percent deduction has encouraged or allowed the providing of health insurance for at least 400,000 people in the United States. That is an incredible number. I think it is a matter of justice and of trying to fulfill our goal of providing health insurance for people.

[Chairwoman Meyers' statement may be found in the appendix.]

Chairwoman MEYERS. At this time I would like to introduce our ranking member, Mr. LaFalce.

Mr. LAFALCE. Thank you, Madam Chairman.

I would ask unanimous consent that my remarks be put in the record but then also let me add this. This is an absolute necessity. This must pass. It must pass as quickly as is possible.

The 25 percent deduction has been a political football over the years, always being used as a bargaining tool for some other tax bill—support the whole bill so that you can get an extension of the 25 percent rather than making the 25 percent permanent. At the very least, that is what should have been done of course. It should have been much more than 25 percent. A generation ago, a decade ago, I introduced legislation to make it 100 percent permanent, and many other Members of Congress did too. There must have been dozens and dozens of bills over the years. In President Clinton's health care reform bill he included a 100 percent deduction provision on a permanent basis. So, conceptually the Clinton administration is supportive of that too. It was their bill, 100 percent deduction, permanent.

We have never been in such bad straits as now. We have never been in a situation where it has expired for an entirety of a year. The year 1994 doesn't exist, and so we are going to have to pass it. We are going to have to make it retroactive to January 1, not of 1995 but January 1 of 1994, but we are going to have to do it before the returns are filed. So, we are going to have to move very, very quickly, and then once we do that, we can go on and probably if we are not going to do major health care reform, and we are probably not, there are some incremental things. Then we are going to have to phase in a greater deduction. We ought to get to 100 percent, but we might not be able to do it in one fell swoop. We will take as much as we can get as quickly as we can get it as long as we get it quickly and permanently.

Thank you.

[Mr. LaFalce's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you, Mr. LaFalce.

This morning we will start our hearing by hearing from witness Betty Stehman.

#### **TESTIMONY OF BETTY STEHMAN, ENTREPRENEURIAL FINANCIAL SERVICES, INC., SILVER SPRING, MARYLAND, NATIONAL ASSOCIATION OF HOME-BASED BUSINESSES**

Ms. STEHMAN. Good morning. My name is Betty Stehman. I am a certified auditor and also my own business. The reason I am interested in this issue is because my entire client base is small business and home-based businesses. I am also the CFO for the Amer-



ican Association of Home-Based Businesses which is based in Rockville, Maryland.

Chairwoman MEYERS. Betty, could you pull that a little closer and speak directly into it because we can hear you but if you don't use the mike those in the back of the room cannot hear.

Ms. STEHMAN. Is this better?

Chairwoman MEYERS. Yes.

Ms. STEHMAN. OK.

When I did the research to prepare my report for this hearing, I realized that approximately 80 percent of all the businesses in the United States fall in the classification of small business or home-based business. Therefore, we have 80 percent of the businesses not able to take 100 percent of their medical insurance expenses as a business expense, which is given you the right in Code Section 162.

In my report I state that the Code section starts out: "There shall be allowed as a deduction all the ordinary necessary expenses paid or incurred during the taxable year in carrying on any trade or business." So the right of small business to deduct at 100 percent is given yet it has been jockeyed around, and now it has been down to 25 percent, and in reality there is always a 7.5 percent amount that is lost permanently by the fact that it flows through the individual taxpayer's return, and that 7.5 percent has to be first eliminated because that is the way the law reads for individual tax returns, and there is no carry-back and carry-forward provision provided for that like there are for C corporations.

So you have got a great deal of inequity going on here, and yet where the job creation is occurring in the economy is exactly in this 80 percent, and in the statistics that I provided in the report, between the time period of 1989 and 1991 the jobs that were created were in the zero to four employee business range, and they created 2.6 million jobs. In the 500-plus employee category, which is the SBA's definition of what constitutes a large business, they had 122,000 jobs created during that same time. All the rest of the segments lost jobs.

So we need to concentrate on the zero to four range, and one way to do it is to make sure that they can provide health insurance for their people or we will have more of a problem in society with uninsured people.

[Ms. Stehman's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much.

Our next witness will be Jeanie Morrisette of the Homestead Construction Company, Annandale, Virginia, and she will also be speaking for the National Association of the Remodeling Industry.

#### **TESTIMONY OF JEANIE MORRISSETTE, HOMESTEAD CONSTRUCTION COMPANY, INC., ANNANDALE, VIRGINIA, NATIONAL ASSOCIATION OF THE REMODELING INDUSTRY**

Ms. MORRISSETTE. Thank you very much, Madam Chairman, members. I was very pleased to be asked to be here today. When my association called and asked me if I had any interest in this subject, I said, "Shoot, I was mad when we only got 25 percent and now I'm here and we are going to get none," so I indeed do have an interest in this subject.

I am Jeanie Morrisette. I am the owner of Homestead Construction Company in Annandale, Virginia. We are a typical small remodeler. We have four employees, and we are the folks who do things like kitchens and bathrooms and room additions. I am also active with our National Association for the Remodeling Industry. It is also known as NARI. I am a past president of that organization here in the metro Washington area.

My company is a subchapter S corporation. We currently provide health insurance to our shareholders; that is, myself and my husband and one other employee. Homestead, my company, can deduct 100 percent of these premiums that are paid for the insurance. However, we the Morrisettes, must turn around and declare this as income on our tax return, on the front page of our 1040. So, our premiums, which fall just a little under \$5,000 a year, get put as income on our W2's. This then means that this entire value is subjected to Federal and State taxes when it is filed on the return. In our case, our taxes in those two categories amount to about a third of the amount. It is my understanding that in some States and depending on your tax bracket it could eat up as much as 50 percent of the premium.

Prior to January 1, 1994, we were entitled to deduct this 25 percent as an adjustment down at the bottom of the front page on the 1040. Now this has been eliminated by virtue of the fact that it is my understanding that it just didn't get voted on again. So, now there's just fewer dollars available to small businesses. These are dollars that are needed to reinvest in small businesses.

We have a really hard time as it is, and at least in my company we are trying to think about funding a retirement plan. I was just 30 years old when we started our business, but that was 15 years ago and all of us are getting older, and my employees who have been with us for a long time are getting older, so there's a lot of interest in other things besides just the health insurance.

Besides the issue of affordability, frankly, we as small business people feel really aggrieved. That we can't deduct at all, that folks who work for IBM don't have to declare their insurance premiums as income and that we have to is frankly pretty galling. It is hard for us to see the argument in that.

I am not proposing that you take away their deduction. Instead, it is my feeling that we should all get that as a 100 percent deduction. It is a good deduction. It does the sort of thing that you as lawmakers want to do. You want to encourage us to provide insurance. A lot of small business owners would be able and would be much more inclined to offer health insurance certainly if there was a 100 percent deduction. We are the ones, we, the small owners, tend to be the subchapter S. We are the small folks. The big people are the C corporations, and they can already deduct it.

I know that this was established in 1986 and that the organization that I belong to, NARI, which is a professional organization for remodelers, has worked real hard since 1989 to keep this deduction, and I know that they have and I know everybody is concerned about money and that you feel like this is just a budget item, but sometimes we are trying to balance the budget with the wrong people. We are the ones who are employing people. I have five employ-

ees. So, sometimes we are just not getting equal treatment. We certainly don't feel like we are getting equal treatment.

I know that there has been a lot of support, and I hear a lot of people saying good things about making this deduction happen and hopefully of expanding it. On behalf of 6,000 NARI contractor companies, we really appreciate that and we certainly think it is on the right track. Extension and expansion of this deduction makes a lot of sense.

I have three reasons that I would like for you to give thought to. One, it is certainly a matter of equity, and we feel that very strongly, that we should be able to deduct it just like a C corporation can. In our case, even the 25 percent when we did have it, if we had a loss we weren't able to deduct it then, heck, in a year that we needed it worse than ever.

Health insurance is a big cost for small businesses. It is often priced out of our range. I have a really awful insurance plan with a \$1,000 deductible, and it still costs \$5,000 a year in premiums, but having the ability to deduct it would certainly make it more affordable for all of us.

I think enhancing this deduction is going to help a lot of people. I understand from a study by the Employment Benefits Research Institute that half of all the uninsured are either self-employed or work for small firms, and certainly I know a lot of small companies that just don't have any insurance at all, so even ours with poor insurance is certainly better than that.

As a contractor and as a business owner, we would surely appreciate that you are having these hearings and are trying to do something about it. Heaven help us, I can't imagine you can make it happen in 2 or 3 weeks, but that is just about what is needed to get it through.

Thank you very much. I appreciate being able to come here and talk to you.

[Ms. Morrisette's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you, Jeanie.

I might mention, I don't believe I did at the beginning, that Betty Stehman also spoke for the National Association of Home-Based Businesses.

Jeanie, we appreciate your comments, and I heard a statistic yesterday in which companies that have between zero and four employees were responsible for 90 percent of all new jobs that were created in the last year, and companies employing 500 or more also created some new jobs, but very few. Now, of course, there has been downsizing, and we are glad that people are becoming leaner and more efficient. Still, it emphasizes the fact, how important small business is and how many jobs are being created by the very small businesses. So, we appreciate your comments.

Our next witness is Richard Enmeier. He is with the Marrick Company of Indianapolis, Indiana, and he is speaking for the National Association of the Self-Employed as well as for himself of course

**TESTIMONY OF RICHARD ENMEIER, THE MARRICK COMPANY,  
INDIANAPOLIS, INDIANA, NATIONAL ASSOCIATION OF THE  
SELF-EMPLOYED**

Mr. ENMEIER. Thank you, Madam Chairman and other members of the committee. It is a pleasure to be here.

As you said, my name is Richard Enmeier. I am from Indianapolis, Indiana, and I fall in the smallest category. I have myself and one additional employee in the Marrick Company in Indianapolis. I am here representing the National Association of the Self-Employed. These are the folks that, like myself, work for ourselves and, again, are faced with this problem that involves the insurance deduction on our health plans. All the previous individuals have said the same thing that I wish to say, that we need the 25 percent deduction, we need the 100 percent deduction. It is very important to us.

I am diabetic, I have also lost all my eyesight, I have very limited vision, and all these things have happened to me during the time I had the self-employed situation with insurance, and it has not been the most pleasant experience having to deal with self-employment insurance because you don't get the same rates that groups get, et cetera.

The NASE has 320,000 members nationwide, and I consider it a privilege to be here to speak on their behalf in front of you folks. I am from Indiana, and I am just a small business owner, and I am not a very eloquent individual sometimes in the words that I use, but I am really honored that I would be asked to be here, Madam Chair, to be able to speak to you.

My company produces three different products. These products are used in the home, also in industry. One product we produce, which is a nontoxic product, nonflammable, odor free, and environmentally friendly is called the Eliminator. I hold the trademark on that, and of course it eliminates dirt. That is the whole idea of an all-purpose cleaner. We also market a rust remover-degreaser which we market to gun stores and also to sporting goods stores. Our product will remove rust from a factory-blued gun without harming the finish. The third product, that we have had most success with, is called the taxidermy formula. We market that nationwide to taxidermists, and it has replaced many of the toxic chemicals, including white gasoline, that they have used in the past as they prepare things for mounting. It works on fur and feathers and also on fish.

Now enough about what we do. Myself and Curtis Taylor are the only two people involved in this company. He has been with me for 7 years, and I thought I would give him a little plug while I was here.

I have even had the good fortune of selling my product to the Smithsonian Institution here in our Nation's capital, and they use it in the cleaning of the birds that they have mounted. They clean the feathers in order to keep them in top condition in their displays.

The self-employed want the 100 percent deduction. We need it. The little guys out there, as the chairman has said, are the ones that are creating the jobs and helping America. Some day I would like to see more employees. I was taken ill and my company hasn't

prospered as I wish for it to, but I have great hopes now that I have recovered and we are on the upswing along with the economy.

I think the other two witnesses have stated the same thing, that the large businesses have all the advantages of the health insurance deduction where it is not available for to us for the year of 1994 at all. Obviously, a rapid enactment of some sort of a retro-active situation is what is necessary before we get involved in the 1994 taxes.

I am a delegate to the White House Conference on Small Business which will be held here in our Nation's capital in June, and one of the topics that we are interested in is this particular deduction. I announced this to our delegation, and many of them were unaware that it had been totally done away with for 1994.

It has been promised several times that we would have the 100 percent deduction, yet it has never materialized. There are a lot of promises coming from a lot of people. The 25 percent is a start, but we need 100 percent. On behalf of the self-employed, this is what we have to have, 100 percent deduction of these premiums. Premiums are high. The lady next to me told you what type of coverage you get. The premiums are high and the coverage is poor.

Most of the coverage we obtain doesn't include doctor visits; it doesn't include any discount on pharmaceuticals. If you go to the emergency room, I'm sorry, unless you are admitted to the hospital my insurance doesn't even cover it. If I am hit by a car I have no insurance coverage whatsoever unless they admit me. So, this will give you some idea of the dilemma we face trying to buy individual health insurance.

I know that this committee will report the findings from these hearings directly to the Ways and Means Committee, and we hope that through them action will be taken as rapidly as possible in order to alleviate the situation that the small businesses and also the self-employed are facing. I want to thank you for the opportunity to be here both to talk to the people in the Nation's capital and also to represent the National Association of Self-Employed. I appreciate your time and your listening to what we have to say.

Thank you.

[Mr. Enmeier's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much, Richard.

We appreciate your statement, and you are right, we are working with the Ways and Means Committee. I have talked with Chairman Archer of the Ways and Means Committee, and I am sure Mr. LaFalce has talked with Mr. Gibbons, the ranking member of the Ways and Means Committee, and we are conveying to them what we find out of particular interest to small business on these tax issues. So far we have had some very strong support for this issue.

Thank you.

Mr. Craig Willett is our next witness. He is with Willett and Associates. He is speaking for himself and for the National Federation of Independent Business.

**TESTIMONY OF CRAIG WILLETT, WILLETT AND ASSOCIATES,  
PROVO, UTAH, NATIONAL FEDERATION OF INDEPENDENT  
BUSINESS**

Mr. WILLETT. Thank you, Madam Chairman.

As you stated, my name is Craig Willett, and I am a small business owner and CPA. The businesses that I own employ less than six employees in each of the businesses. I am also, along with Richard, a delegate to the White House Conference on Small Business in 1995, and I am submitting my testimony today on behalf of the National Federation of Independent Business.

I want to take this opportunity to thank you for inviting me to testify and to thank NFIB for participating in this hearing today. I would like to commend you for bringing this matter to the attention of our Nation and the urgency of the health insurance deduction for the self-employed. I am hopeful that this hearing will begin a process by which a major unfairness in the Tax Code will be corrected and eliminated.

As was alluded to by others on the panel, self-employed business owners pay approximately 30 percent more than larger companies for similar benefits because of higher administrative costs. In addition, they often pay another 30 percent in premiums for specific types of coverage which are mandated by the States. This often prevents self-employed business owners from shopping for not only the basic care that their employees need but also for other specific provisions that some particular people in their firm might need.

Larger firms that self-insure, by contrast, are not only subject to the costly mandates but also the self-employed usually lack the access to cost saving, managed care arrangements because of a reluctance by insurers to create and market them in small and rural areas. Additionally, a small unincorporated business is far more likely than others to feel the painful brunt of both economic and emotional distress of preexisting condition exclusions.

When an employee gets sick, sometimes the premiums are raised from 20 to 300 percent and often insurance companies cancel their insurance policy. Insurance companies are much more likely to require exclusions, raise premiums, or cancel policies to shield themselves from the risks when insuring a small firm.

As a small business owner, I felt abandoned during the health care reform debate during 1994. Little consideration was given to the self-employed. Consequently, as was stated here earlier, the self-employed currently have no available deduction for their insurance premiums. This lack of tax deduction makes health insurance artificially more expensive for the self-employed. My wife Carol and I have three sons, Paul, Michael, and Matthew, 6 years old, 3 years old, and 6 months old. Our health insurance premium is \$413 per month. On a comparable basis with other taxpayers who can deduct or exclude from their income the cost of their insurance, my health insurance actually costs me \$578 per month. That is \$165 a month more than those people who can exclude it. This is one of the most unfair treatments in the Tax Code that presently exists.

I am encouraged to hear that the Ways and Means Committee will attempt a 25 percent deduction for health insurance retroactive to January 1, 1994, but I don't think this is enough. The Congress should not stop here but should increase the deduction to 100 percent and make it permanent, allowing equal treatment for all taxpayers. Unless Congress acts before April 15, the self-employed business owner will experience a tax increase on their 1994

tax return. I was encouraged today to hear Mr. LaFalce indicate that this needs to be taken care of as rapidly as possible and certainly before April 15, and I would say as a tax return preparer, the sooner the better because people file their returns before April 15.

Madam Chairman, I would like to thank you for your leadership in this area, as is demonstrated by your introduction of H.R. 442, and was also encouraged to hear your comments today that you would like to extend your bill to include a 100 percent deduction.

I want to urge this committee and Congress to end the health insurance tax deductibility status quo and address the tax fairness issue head on. Specifically, I recommend that the 25 percent deduction be retroactively reinstated and that Congress be serious in its intentions to help reduce the cost of health care and make it more accessible.

I have clients who, if they could afford health insurance, i.e., if they were entitled to a fair tax deduction, would provide it for their employees, but how can they provide it for their employees when they cannot deduct it themselves and make it less costly for themselves? I would like this committee to herald a cause for fairness on small business. Maybe the way to do it is to prove that it will not cost as much in the budget process. I suggest that the typical budget scoring numbers that are being used currently are out of date.

In 1994 the IRS issued private letter ruling number 9409006 combined with revenue ruling 71588 and a new technical advice memorandum. A self-employed business owner may deduct 100 percent of his health insurance premium, but there are some catches to it. The self-employed business owner must employ their spouse as a bona fide employee and have a health insurance plan that covers all of the full-time employees of the business. Given this development, some of the self-employed will be able to deduct 100 percent of their health insurance but some will be discriminated against: Partners in partnerships, members of LLC's and 2 percent or greater shareholders in S corporations. Until the impact of this new ruling is estimated, the excuse of the cost to revenue is inappropriate and is not pertinent. I would urge this committee to determine the new cost based on this ruling.

My wife, who has been an employee of my firm for a long time, is now the primary insured on my policy. In 1995 I will be able to take 100 percent deduction, but in 1994 I was not in a position to do this. I have also been encouraged to incorporate my business by my attorney. By electing the S corporation status I will lose the 100 percent deduction that I am positioning myself to take in 1995.

I ask you, why should we have to jump through hoops to try to qualify for 100 percent deduction? Why discriminate against the remaining self-employed? I am encouraged that this hearing will emphasize the need for greater fairness in the Tax Code and would encourage you to grant the 100 percent deduction in encouraging the Ways and Means Committee to do their proper job and make the Tax Code fair.

Thank you, Madam Chairman.

[Mr. Willett's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much, Craig.

I think you are aware that the cost of the program is probably the only reason that we are talking about 25 percent instead of 100 percent. It is about \$400 million a year or about \$1.8 billion over 5 years. I think it would be utilized by more people, if we made it permanent. People don't like the idea of going along year to year being uncertain as to whether or not coverage is going to be reinstated.

However, it is a matter of whether we pay for it now or pay for it later. A number of small businessmen and women that don't have health insurance, become recipients of Medicaid, and so we pay for it one way or the other. I certainly agree with you that it is a cost-effective method.

Before I introduce our last witness, I would like to recognize Peter Torkildsen for a unanimous consent request.

Mr. TORKILDSEN. Thank you, Madam Chair.

I appreciate you holding the hearing on this important subject, and I just ask unanimous consent to submit a statement in favor of the 25 percent deduction with the eventual 100 percent deductibility for the self-employed health insurance premiums.

Thank you.

Chairwoman MEYERS. Thank you. Without objection.

[Mr. Torkildsen's statement may be found in the appendix.]

Chairwoman MEYERS. I would like to recognize Lisa Sprague. She is a manager of employee benefits, Small Business Center, and she is speaking for the U.S. Chamber of Commerce.

#### **TESTIMONY OF LISA SPRAGUE, MANAGER OF EMPLOYEE BENEFITS, SMALL BUSINESS CENTER, U.S. CHAMBER OF COMMERCE**

Ms. SPRAGUE. Thank you very much.

Chairman Meyers, members of the committee, I am the manager of employee benefits policy for the U.S. Chamber of Commerce. As you know, the Chamber counts among its members 215,000 businesses, 96 percent with fewer than 100 employees and 71 percent with fewer than 10. We appreciate the opportunity to appear today to comment on the issue of health insurance deductibility for the self-employed. Few issues are as clear-cut and convincing. Restoration of the 25 percent deduction is a top legislative priority for the Chamber. Further, we regard full deductibility as a vital and indispensable goal.

The business community has been the driving force in the continuing evolution of the health care delivery system and in slowing the rate of increase in health care expenses. We know that employers provide health insurance for the majority of those Americans who are insured. That is over 55 percent, I should say, not the 85 percent that was printed in my written statement. Small business, including the self-employed, plays a role in health system development as well as in job creation, yet the self-employed continue to be isolated and denied in terms of health insurance deductibility.

The U.S. Chamber's membership is diverse, and at times this can result in varying priorities within a given legislative issue, particularly one as complex as health care, but we have yet to hear from a single membership constituency, or indeed a single member, a



suggestion that equity in the deductibility of health insurance should not be a top priority for the Chamber as a whole.

Madam Chairman, you noted that from 1986 on, a 25 percent deduction for self-employed persons was granted and repeatedly extended until Congress failed to renew it in 1994. Ironically then, the one measurable result of the health reform debate that dominated the year was that the most vulnerable of those who provide health insurance were left in worst straits than before. The Chamber calls on Congress to restore the 25 percent deduction for 1994 and to do so quickly enough that self-employed filers may reflect it in their 1994 tax filings.

To be sure, restoration of the 25 percent deduction is no more than a quarter of a loaf. I join my fellow panelists in stating that what is really needed is legislation to permit 100 percent of deduction of health insurance costs. Recognizing, along with you, that the major obstacle to such action is its cost in tax revenues, the Chamber is certainly willing to consider a phased-in approach to 100 percent deductibility. What we cannot accept is that the smallest businesses, frequently new and often struggling, should be denied a measure of security granted to larger businesses.

The U.S. Chamber of Commerce wishes to commend this committee for drawing attention to an issue that has been a thorn in the side of the Nation's smallest businesses for many years, and we look forward to working with you to remove it.

Thank you.

[Ms. Sprague's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much.

I think all of you have set forth the problem very well and its impact on your business.

I would like to recognize members for questions in the order in which they arrived at the hearing, and I will start with Mr. Bartlett.

Mr. BARTLETT. Thank you very much. I really appreciate your coming and your succinct and clear testimony this morning.

I was, before I came to the Congress, a small business person, and so I am very keenly aware of your problems. Small business is not simply hit with a double whammy here but with a triple whammy. First of all, the kinds of insurance that small business people can acquire are frequently less desirable than that which can be acquired by large businesses. Preexisting conditions frequently discriminate against small business owners. The insurance companies—and the basic philosophy of insurance is to spread the risk—they now are more and more often trying to avoid the risk.

There are no culprits here, unless the culprit is the U.S. Government. Back after World War II, we imposed wage and price controls so that employers who were trying to attract a small, relatively small, pool of employees as compared to the large number of jobs available could not offer more money, so they offered some other incentives, and they chose health care insurance as that incentive. Up around that grew the Big Blues and the present situation, so I think many of the ills of go back to very unwise actions on the part of the Government imposing wage and price controls.

Well, this is the first whammy that you can't buy the same quality of insurance. The second whammy is that you pay more for it.

You pay more for poorer insurance. Then third, you can't deduct the cost of it.

This is so manifestly unfair that one wonders how for, what, 8 years now small businesses had only a 25 percent deductibility and nothing for last year, where large businesses have 100 percent deductibility for better insurance which can be purchased more economically by them—more cheaply by them.

I don't really have any questions. You have answered all the questions, I think, that could be asked. It just is grossly unfair, and we need to move as quickly as possible to correct the inequity.

Thank you very much for coming and for your testimony.

Chairwoman MEYERS. Thank you, Mr. Bartlett.

Mrs. Clayton.

Mrs. CLAYTON. Well, I want to thank you too for coming and expressing what is justly unfair in terms of small business. I, too, come from a small business background, having employed persons, ranging from 5 to 10 persons. Also, I recognize that it is unfair not only to self-employed but small business itself because of the economy of scale.

I just want to walk through a couple of things. Did I understand Jeanie Morrisette—you are an S corporation, so you enjoy the 100 percent deductibility, but then you must report it on your taxes as income. So, you are taxed on that approximately one-third as premium.

Ms. MORRISSETTE. That is correct.

Mrs. CLAYTON. But Craig Willett, you had another way of getting 100 percent deductibility without incorporating. How do you do that?

Mr. WILLETT. The S corporations are not—if you are a 2 percent of greater shareholder and employee of an S corporation, you cannot deduct any of your insurance. I said there was a private letter ruling that the IRS issued in 1994 that stated if you are a sole proprietor, unincorporated business, and you employ your spouse in your business as a bona fide employee, and that spouse becomes a primary insured on the insurance policy, and you offer full health insurance benefits to full-time employees of your firm, all of them, then you can deduct 100 percent.

It is a situation where someone was trying to explore, well, if I hire my husband to work for my business, I think was the question posed to the IRS—if the business owner employed her husband to work for her and her husband got the insurance policy for his health insurance premiums and was the only employee of the business, could they deduct it, and the answer came back, yes they could.

So what I am saying—I bring up on the point that the budget scoring and the cost that Mrs. Meyers alluded to, the \$2 billion on getting 100 percent, is incorrect now, I think, given this new ruling, because there will be people who actually employ their spouse in their business on a bona fide basis and provide insurance benefits to all their employees who will now be able to deduct 100 percent, and so the \$2 billion may not be correct.

I would also like to ask the committee to ask what it costs in welfare programs for people who are uninsured, what it is costing on the other side, because I think our budget scoring process is

wrong when they are not looking at what those people in charitable care or in Government-sponsored programs that they have to participate in, such as Medicaid and Medicare, to get some of their health costs covered.

I think we are just creating a catastrophe by waiting that long, and, looking at \$2 billion, sure it is a lot of money, it is a lot of money to everybody, but I think the dollar amount is incorrect, and that is what I would encourage this committee to look at when they score this for the budget. I think the \$2 billion is wrong given this new ruling.

Mrs. CLAYTON. Do I still have time?

Chairwoman MEYERS. I think your time is almost up, but frankly I wasn't watching. Go ahead and ask another question.

Mrs. CLAYTON. I wasn't going to ask another question, I was just going to conclude with a comment. I think this committee obviously is the committee that is the advocate for small business, but what we are trying to do is to understand how we make the issue well, and particularly if we are going to make it retroactive.

I, for one, want to go to 100 percent, but we can't ignore that in this climate there is a concern about what things cost. So, if there is additional information that will help to recognize this does not cost, I think this committee, at least I as a member of this committee, would be very helped if you would provide that information to us.

Mr. WILLETT. I think NFIB would be happy to do some research on that and submit something to you.

Mrs. CLAYTON. Thank you.

Chairwoman MEYERS. We would appreciate that.

Mr. Chrysler.

Mr. CHRYSLER. Thank you. I appreciate being here. I kind of wish I was down there. I feel like I always have been, but I am glad I am up here so I can make a difference.

I think Betty's chart is very appropriate, and everybody ought to take a look at this chart and understand it. I know I have showed it to the committee, and the typical response I get is, "Wow."

Last year's Congress left us with a real opportunity, and that is to make health care 100 percent deductible retroactive to January 1994. I know when we first met in caucus here we went around the room with the Republicans, and I think all of us agreed that that is what we needed to do as long as we had this very unique opportunity left over to us by the 104th Congress, and I know I just feel very strongly what is good for the goose is good for the gander. We need 100 percent deductibility of health care premiums for small businesses. We need to have medical savings accounts that will give us portability and cover preexisting conditions, and we need tort reform if we are going to do what we need to do in this country to make our small businesses competitive, and I would like to make a strong recommendation to the Ways and Means Committee that we have 100 percent deductibility retroactive back to January 1994. If we can afford it in 1995, then surely we can afford it in 1994, and I would like to make that recommendation, Madam Chairman.

Chairwoman MEYERS. Thank you. Mr. Chrysler. We appreciate it.

Mr. Mfume.

Mr. MFUME. Thank you, Madam Chair.

I don't have any questions of the witnesses. I have their testimony. I expect to go through that.

As you know, I am a cosponsor of the legislation to restore the health care tax deduction for the self-employed, so I welcome the hearing and I certainly want to congratulate you as chair of the committee for calling us together on this.

I would ask unanimous consent, pursuant to the rules, that my official opening statement be made part of the formal record and as an observation just like to say it is good the see Mr. Willett again—three times in 3 weeks. I have a funny feeling we are going to get to know each other very well.

Thank you.

[Mr. Mfume's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you, Mr. Mfume.

Mrs. Kelly.

Mrs. KELLY. I have no statement at this time, Madam Chairman, but I ask unanimous consent to have a statement inserted in the record at a later time, without objection.

Chairwoman MEYERS. Without objection.

[Mrs. Kelly's statement may be found in the appendix.]

Chairwoman MEYERS. Mr. Bentsen.

Mr. BENTSEN. Thank you, Madam Chairman, and I want to thank the panel. I don't have any particular questions. I have a statement I would like to insert in the record if possible.

I will say that I agree that this is a deduction that needs to be restored and I think it probably needs to be increased. I think this carries on with the hearings that we have had this week in particular, the hearings yesterday. As we see a change in the structure of business in this country and more self-employed and more small businesses, more home offices—again, here we have more self-employed—that they should not be treated differently under the Tax Code than large businesses are. So, I wholeheartedly endorse what you are trying to do here, and I think we ought to take it further.

[Mr. Bentsen's statement may be found in the appendix.]

Chairwoman MEYERS. I thank you, Mr. Bentsen, and I know that we are all going to talk to people on the Ways and Means Committee and especially emphasize the need for quick action in making it retroactive for 1994, or else it is going to mean that all of our small businesses who file their income tax forms are going to go back at a later time and have to file an amended form which is a hassle and costly to small business. So, we hope that it is done in a timely manner.

Mrs. CLAYTON. Madam Chairman, do you know the schedule of Small Business considering this? Are we expected to push the schedule.

Chairwoman MEYERS. Well, they have held hearings also or will on this issue, I believe, and they are aware of the need to get this accomplished so that people will not have to go into filing amended returns after they have already done their 1994 tax returns. So, I think they are aware of it.

I just think that another voice is always helpful, and we will convey this information to them, and if all of us can speak to our friends I think that will be helpful.

Mrs. Smith.

Mrs. SMITH. I don't have a statement or comment at this time. Thank you.

Chairwoman MEYERS. All right. Thank you.

Mr. Talent.

Mr. TALENT. No statement or questions, Madam Chairman. I just want to associate myself with the remarks the other members have made.

This is an issue in which there is obviously unanimity on the committee, and I think in the House and we simply have to follow through and get it done. I appreciate your holding the hearings, Madam Chairman.

Chairwoman MEYERS. Thank you, Mr. Talent.

Mr. Tucker.

Mr. TUCKER. Not at this time. Thank you, Madam Chairman.

Chairwoman MEYERS. Thank you.

Mr. Longley.

Mr. LONGLEY. Thank you, Madam Chairman.

I am really fascinated with some of the statistics that are offered, Ms. Stehman, and I just want to preface my question with a comment that I think—and from my own experience working with many small businesses and, again, like Representative Chrysler, sometimes I have maybe a little more empathy with having been sitting on the other side of the table.

I think as our economy has become far more competitive, that the tax burden as a relative amount of pressure on a business has become extremely onerous, and I am really struck with the numbers where you are suggesting that approximately 15.6 million businesses are one-person shops or family run businesses, and I am wondering if you have any information that relates to what percentage of those individuals would actually prefer to be working for a company or what percentage of that 15.6 million—in other words, if there were a regular job available—and I am not suggesting that somebody that works out of their home does not have a “real” job, but my sense is that a significant percentage of these individuals would prefer to be in the larger work force if sufficient opportunities were available and/or what percent in addition, going over and above the 21.3 million—to what extent do we have noncompliance with the system, meaning folks who have concluded that (a) the tax burden is too onerous, and (b) the paperwork burden is too onerous and they have effectively opted out and more into the underground economy. I think it is a significant problem.

Is the question clear?

Ms. STEHMAN. Well let me respond, and then we will see if I answered your question. If I understand, what you are asking is, how many of that 15.6 million would be in a real job—in what a lot of people think of as a real job, i.e., working for IBM or Unisys or one of the large corporate Fortune 500 companies? There is no way to tell. You would have to go out and do research on it.

Would they admit what they would really like? A lot of them, my hunch—and this is only a hunch—is that they are forced into it

through downsizing. Currently dealing with a downsized husband, that is exactly what we are looking at—what are his options? Having been a founder of the American Association of Home-Based Businesses and getting out and dealing with a lot of downsized people, entrepreneurs, once they are out there and if they really enjoy it, probably don't want to go back, they want to stay self-employed. They like the freedom, they like the flexibility. So, would that number shift? I don't think so. I probably think it is low. I think it is higher than that. Link Resources of New York lists that they estimate that there are probably 24 million home-based business people. So, there is a substantial difference there.

You can't get home-based business people, for instance, to often-times admit that they are because of restrictive legislation within their own jurisdictions, so they stay under the carpet and they don't admit what they are doing.

Mr. LONGLEY. Again, I am really trying to nail down two different numbers. One is, of the 15.6 million, is there any demonstrable evidence that would indicate that a certain percentage would actually prefer to be employed in a larger work environment, not be in a one-person shop?

Mr. WILLETT. I think the answer to that—we might take a straw poll of the panel here today. I know, myself, I would not go to work for a large company given the choice, and in fact, I left the employ of a large company on my own to start my own business, my own practice, and own several other businesses, and I look at my client base that I do as a tax expert, and I could say that most of them, a majority, without doing a statistical analysis, but a majority of them enjoy, and, frankly, really enjoy owning their own business, having that flexibility, and I have a lot of friends who have taken the choice to leave large companies and haven't been forced out in a downsizing on their own free will to do that, and I think there are a lot of people in America that enjoy being entrepreneurs.

Mr. LONGLEY. I am not suggesting that they don't, but I am also suggesting that from what I have seen at least in my own State, there are a number of people who have started home-based businesses as the best alternative for them available for them to provide for their families.

The second part of my question is, of those 15.6 million who would be individually employed, how many of them perhaps might add employees or would consider adding employees were it not for the onerous tax and regulatory burden that they would incur by creating a job?

Mr. WILLETT. I indicated in my testimony today that I have a lot of clients who are self-employed who would provide health insurance who are employees if they were able to take a deduction so they could afford their own health insurance. So, I think your question is going down the right path. The high cost of the self-employment tax and the regulations related to that and the payroll tax impose a heavy burden on small business owners. There would be a lot more people who would employ others if they didn't have to go through a costly regulation and compliance burden, and not only that but the high cost of the tax. A lot of my clients, the highest tax they pay is the self-employment tax, sometimes two and three times what they pay in income taxes.

Mr. LONGLEY. I just would for the record indicate my complete support of the 100 percent deduction and would suggest that that is one small piece of the larger issue of what I view as the onerous tax and regulatory burden on small business, and particularly coming back to the chart, I am absolutely convinced that it is costing us millions of jobs.

Thank you, Madam Chairman.

Chairwoman MEYERS. Thank you, Mr. Longley.

I am going to ask a few questions at this time.

What would it mean to each of your businesses if you could deduct 100 percent of your health insurance premiums? Maybe you can't answer this exactly at this time, but I wonder, would you opt for better coverage, hiring another employee, expanding your business, or less dramatic changes?

Why don't we start with you, Betty?

Ms. STEHMAN. I have just gone through an analysis prior to my husband's downsizing and decided at this point to go with an independent contractor so that I could expand as I was grossly overworked.

Now with the issue of the fact that I may roll him into my company, and I am a subchapter S, I am very concerned about it, and I was just working on some numbers last night in relationship to this, as to what is it going to cost us at this point. I can't give you a definitive dollar figure, but it definitely has an impact on what we will do, and there are a lot of other people who are in that same situation.

Chairwoman MEYERS. Jeanie.

Ms. MORRISSETTE. We would seek better health insurance. We are providing some health insurance now, but, as I mentioned, it is poor. We pay \$5,000 a year in premiums with \$1,000 deductible policy. So, we have never met our deductible except during 1 year, and we are glad that we haven't, but it is pretty scary.

Chairwoman MEYERS. Mr. Enmeier.

Mr. ENMEIER. I would agree with her that I would definitely opt for the better health insurance coverage. I made that clear in my testimony, and the deduction would of course give us additional funds to be able to do that.

The health insurance coverage is very important to me because these illnesses have come on me later in life. I was a healthy person and felt good, and all of a sudden the body deteriorates with age and you are in trouble.

I would definitely opt for the better coverage, Madam Chair.

Chairwoman MEYERS. Very good.

Mr. Willett.

Mr. WILLETT. I am actually in the process of looking at a higher deductible insurance policy, and so being able to take a 100 percent deduction, I would not look for more or expanded benefits for myself, but I would actually look for some additional cost savings in the health care area for me and for my employees, and I would invest that in additional equipment in my business and I would think within 6 months be able to hire another employee and expand my firm growth.

Ms. SPRAGUE. If I may speak on behalf of the many Chamber members with whom I have discussed this issue, I think I would

have to say first and foremost I would go along with what Ms. Morrisette and Mr. Enmeier have said, that most of the people who talk to me about this say that they would like to be able to secure better health insurance coverage for themselves and their families first.

Chairwoman MEYERS. All right. Thank you very much, Lisa.

I am going to ask another quick question because we do have a vote.

Ms. Morrisette, your company is organized as a subchapter S and therefore falls under the 25 percent deduction limit. Some people may look at your situation and wonder why you don't just organize your business as a full C corporation. Can you comment on that, and why do so many small firms prefer to be structured as sole proprietorships, partnerships, and S corporations?

Ms. MORRISSETTE. I think so many small businesses prefer that because initially it is easier, there is less paperwork involved, and frequently when you start in business you are just really small. When we started, there were just two of us; now there are nine of us. So, sometimes companies outgrow the status which they select early on, and our accountant presented subchapter S as being the best way to go, and that was back in 1980, so things have marched on, and, yes, we are looking at becoming a C corp, but I sort of hate having to pay the money to do it, having to go through—as the gentleman down here said, jump through the hoops to put us into some different category.

Chairwoman MEYERS. All right.

Well, I thank you all very much. We appreciate your comments. We will pass them on, and at this point we are adjourned.

[Whereupon, at 11:04 a.m., the committee was adjourned, subject to the call of the chair.]



## APPENDIX

---

**STATEMENT OF CONGRESSWOMAN EVA M. CLAYTON  
BEFORE THE COMMITTEE ON SMALL BUSINESS  
UNITED STATES HOUSE OF REPRESENTATIVES  
"DEDUCTIBILITY OF HEALTH INSURANCE COSTS  
BY THE SELF-EMPLOYED"**

**Madame Chairwoman,** The issue with which we are charged to investigate today is clearcut and straightforward. Traditionally, corporations have been permitted to deduct one hundred percent of the cost of providing health care benefits for their employees. Under the 1986 Tax Reform Act for a period of three years, self-employed persons were permitted to deduct twenty five percent of their health care costs. Although sufficiently lower than the one hundred percent deduction allowed Corporations, it was thought at the time that the twenty five percent was high enough to encourage self-employed persons to invest in health care insurance and to create a level of equity between large companies and small businesses. Never permanently written into the law, this deduction was extended past the original three year time frame each year until December 31, 1993.

At present, there are several bills before this committee that attempt to rectify this situation. Some would permanently reinstate the twenty five percent deduction, while others would look to increase the deduction to a full one hundred percent, bringing self-employed persons to a level equal to that of large corporations. I am also encouraged by our chairwoman's bill. Thoughtful and well considered this bill would reinstate the twenty five percent deduction for 1995 and look to future bills to increase the deduction to one hundred percent in the years ahead. However, I believe that this approach is overly cautious, in that it relies upon future bills to establish a deduction level of one hundred percent. I believe that we can, even given the nature of our current deficit situation, establish the one hundred percent deduction this year, rather than wait to do so in future legislation. This hearing should help in our consideration of all of the proposals on this matter. I look forward to working with my fellow colleagues on both sides of the aisle to quickly pass legislation that will create a greater degree of equity between large companies and small businesses and that would give incentives to self-employed persons to invest in health care insurance

STATEMENT OF REP. JOHN J. LaFALCE (D-NY)  
Ranking Minority Member, House Committee on Small Business  
DEDUCTIBILITY OF HEALTH INSURANCE COSTS BY THE SELF-EMPLOYED  
January 20, 1995

Our last hearing this week is not the least important. In fact, for very small businesses this issue is as, or more, important than anything in the Contract with America.

Congress has been addressing the issue of the self-employed tax deduction on a piecemeal basis since 1986, extending the deduction for only a few years at a time. We in the Small Business Committee have followed the issue closely, and I supported efforts to raise the deduction to 100 percent in health care reform legislation. This issue is now overdue for action, and I fully support the self-employed in their efforts to act responsibly and purchase health care coverage.

I agree that we should not only restore the 25 percent deduction, but also raise it back to a full 100 percent. I have cosponsored a bill in this Congress that would phase-in the increase over five years. I also appreciate the need for quick passage of this bill, so that all of the small businesses that have relied on this deduction will be able to claim it when they file their returns this Spring.

I look forward to the testimony today, and I look forward to working with Chairwoman Meyers and all of the Members of this Committee to get this legislation through Congress promptly.

STATEMENT OF  
REP. JAN MEYERS (R-KS)  
CHAIR  
COMMITTEE ON SMALL BUSINESS  
U.S. HOUSE OF REPRESENTATIVES

JANUARY 20, 1995

"Health Insurance Deductibility for Self-Employed Individuals"

Good Morning Ladies and Gentlemen. Our hearing this morning is the fourth in our series of hearings devoted to Tax Policy and Small Business. This morning we will focus on the health insurance tax deductibility of taxpayers to take a tax deduction for a home office that is used in the course of business.

The 25% health insurance tax deduction was enacted by Congress in the Tax Reform Act of 1986 (P.L. 99-514), extended in The Tax Extension Act of 1991 through June 30, 1992 and extended again for an additional one year in The Omnibus Budget Reconciliation Act of 1993 from July 1, 1992 to December 31, 1993. However, as of December 31, 1993, self-employed individuals, farmers and small business owners will NOT be able to deduct any portion of their health insurance costs.

For purposes of the 25% tax deduction, self-employed individuals include sole proprietors, working partners, and employees of an S corporation who own more than 2% of the corporation's stock. No deduction is permitted if the self-employed individual is eligible to participate on a subsidized basis in a health plan of an employer of the self-employed individual or individual's spouse.

There is evidence that the 25% deduction allows hundreds of thousands of business owners to purchase health insurance--those who otherwise could not afford it. However, Congress has essentially dangled the deduction over the self-employed every year temporarily extending the deduction since 1986. Furthermore, the deduction is not equitable to the 100% permanent deduction allowed corporations for their health premium expenditures.

Now that tax forms are in the mail, failure to act now to preserve at least the 25% deduction means that small owners will not be not be able to deduct a dime of their 1994 health insurance costs for themselves and their families. This could result in an estimated increase of 412,000 in the number of self-employed individuals without health insurance, further exacerbating the growing problem of the uninsured in our nation.

I, and several members of the 104th Congress, have introduced legislation to retroactively restore the tax deduction. My legislation would not only restore the 25% health insurance deduction for FY94 but also make it permanent in order to avoid the year-to-year anticipation and possible disappointment of many of this nation's very small entrepreneurs. Then, I intend to offer a proposal to gradually raise the deduction to 100% encouraging our small businessmen and women to purchase health insurance for themselves and their families.



***National Association for the Self-Employed***

TESTIMONY OF  
MR. RICHARD ENMEIER  
SMALL BUSINESS OWNER, THE MARRICK COMPANY

REPRESENTING THE  
NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED

BEFORE THE  
COMMITTEE ON SMALL BUSINESS  
U.S. HOUSE OF REPRESENTATIVES

ON  
THE DEDUCTIBILITY OF HEALTH INSURANCE PREMIUMS  
FOR THE SELF-EMPLOYED

JANUARY 20, 1995

*"Serving the Needs of Small-Business America"*

---

Member Services: 2121 Precinct Line Road • Hurst, TX 76054 • 1-800-232-NASE

Madam Chair Jan Meyers, Ranking Member John LaFalce, and members of the House Small Business Committee, my name is Richard Enmeier and I am a self-employed small-business person. Thank you for inviting me here today to testify on the issue of deductibility of health insurance premiums for the self-employed. I am pleased to be here representing the National Association for the Self-Employed of which I am a member. The NASE represents over 320,000 small business persons throughout the United States and strongly supports 100 percent deductibility of health insurance premiums for the self-employed. This is an issue of paramount importance to the membership, especially myself.

I come from Indianapolis, Indiana, where I own the Marrick Company. I have been an independent businessman since 1980. I have one other employee along with myself who has been with me for six years. The Marrick Company produces three chemical products. The first product is called "The Eliminator" and is an all-purpose cleaning solution sold in concentrated form. It is non-toxic, odor-free and non-flammable. The second product is a rust remover and degreaser. It is sold in most sporting goods stores and used by hunters and gun aficionados. It can clean a "factory-blued" gun without harming the finish, and the black powder from older model guns. The third product is the Taxidermy formula. It replaces the toxic chemical used by taxidermists while preparing a trophy for mounting. It removes blood, grease and oil from fur, fish and feathers. The Smithsonian Institute has purchased this product from me to use in cleaning their stuffed bird displays. These products are blended and mixed from scratch using a secret formula. I market my

products throughout the U.S. by telephone and direct mailings.

Being self-employed, the issue of the 100-percent deduction of health insurance premiums is very important. I happen to be legally blind and have diabetes. I absolutely need to maintain my insurance. Being allowed to deduct a portion of the costs of my premiums is very helpful to my pocketbook. However, I know that a large business can deduct 100 percent of the costs it pays for employees' health care benefits. I do not understand why someone who is self-employed cannot have the same luxury. Plain and simple...small business isn't being treated fairly.

Current inequities in the federal tax law make it more difficult for the self-employed to be able to afford health insurance. It has been a long-standing practice under the tax law that corporations have been permitted to deduct all of the health insurance premiums paid on behalf of their employees. However, it wasn't until 1986 that Congress attempted to rectify to any degree the disparity in the tax treatment of health care expenses between unincorporated businesses and corporations. Beginning in 1986 and continuing through the end of 1993, self-employed persons had been permitted to deduct 25 percent of their health insurance premium costs from their taxes. But this still means that a self-employed individual purchases a health care policy at a higher rate because they pay with after-tax dollars, while an employee of a large corporation has their policy paid for with pre-tax dollars.

Presently, there is no deduction for the self-employed at all. You may be wondering how something like this could happen. Congress did attempt to address

the issue last year, within the context of health care reform. Throughout the initial discussions on reforming our health care system, the self-employed were promised that their quest for a 100 percent health insurance deduction would be answered affirmatively through the passage of final health care legislation by Congress. The NASE had every reason to believe this -- the 100-percent deduction had been a common theme in every major health care bill introduced in Congress in 1993 and 1994, including President Clinton's Health Security Act. Last year, everyone assumed that the deduction would be re-instated to at least the 25-percent level. Most of the major legislation addressed the issue retroactively and raised the deduction to 80 or 100 percent over a period of time. However, when health care reform died, so did the deduction.

Tax season is upon us and I believe that many of the self-employed are going to be surprised to find out they have no deduction for the 1994 calendar year. The deduction expired on December 31, 1993, and to date, it has not been re-instated. Several bills have been introduced this Congress that would reinstate the 25-percent deduction for 1994 and raise it to 100 percent from 1995 on. The NASE and I support those pieces of legislation. We also commend Rep. Archer, Chairman of the House Ways and Means Committee, for stating that the issue would be addressed quickly so that the self-employed can take the deduction on their 1994 tax returns and avoid filing amended returns.

Reinstating the 25-percent deduction merely retains the status-quo. This is not equal to the treatment of big business. The 100-percent deduction is not only



important for tax equity purposes, but it would also greatly assist the self-employed in the purchase of health insurance. Nearly three million self-employed individuals are currently uninsured. Many small firms can't afford to cover themselves or their dependents. If a self-employed individual could deduct the full cost of health care coverage, the number of uninsured Americans would decrease drastically. If Congress really wants to increase health insurance coverage of small businesses and their employees, studies show that a full deduction is the most fair and effective way to do it.

Unfortunately, we have found the road towards 100 percent deductibility to be one with many promises and little delivery. Even retention of a 25-percent deduction since 1986 has been fraught with much frustration. Every year the self-employed community would be promised a permanent, full deduction of their health insurance premiums, only to find themselves held hostage to federal revenue and budgetary concerns. In this way, self-employed persons have found their partial health insurance deduction subject to continual renewal on a year to year basis.

I urge the House Small Business Committee members to work with the Ways and Means Committee and take immediate action to ensure re-enactment of the 25-percent deduction for 1994 and raise the level to 100 percent for 1995 and beyond so that the self-employed can buy quality health care coverage for themselves and their families.

**Statement of  
Jeanie Morrisette, Homestead Construction Co., Inc.  
before the  
House Small Business Committee  
regarding the  
Reinstatement of the Self-Employed Health Care Deduction  
January 20, 1995**

Madam Chairman, honorable members of the Committee, I am honored to provide testimony on the proposed reinstatement of the self-employed health care deduction. My name is Jeanie Morrisette and I am the owner of Homestead Construction, Company, Inc. Homestead Construction is a small remodeling firm located in Annandale, Virginia, specializing in residential remodeling. I am also a past president of the Metro Washington chapter of the National Association of the Remodeling Industry (NARI).

Homestead Construction is a Subchapter S Corporation that currently provides health care insurance to its shareholders— that being myself and my husband. While Homestead can deduct one-hundred (100) percent of the health insurance premiums, under current tax law, as shareholders, we must report the value of the premium, which is over \$5,000 a year, in our W-2s. This then subjects that value to federal and state income tax on our individual returns. In our case, the taxes are more than one-third ( $\frac{1}{3}$ ) of the value of the premiums. The tax could easily be

over fifty (50) percent of the premium, based on an individual's state of residence and tax bracket.

For tax years prior to January 1, 1994, we were entitled to deduct twenty-five (25) percent of the value of the premium as an adjustment to income, on Page One (1) of Form 1040. The twenty-five (25) percent deduction has now been eliminated, since Congress has not passed any legislation to extend the deduction that expired on December 31, 1993. The elimination of this partial deduction, along with the taxation of our health insurance premiums, results in fewer spendable dollars. These dollars could be used to reinvest in my business, to fund a retirement plan, or to save for our child's education. With the continued rise of health care costs and the associated tax burden, we, as small business owners, will have to seriously consider whether continued coverage is possible.

Besides the question of affordability, I believe it is patently unfair for S Corporation shareholders and other self-employed individuals to pay tax on these benefits, while C Corporations and their employees enjoy 100 percent deductibility with no strings attached. Please do not misunderstand me, I am not

advocating that all employee health care benefits be taxed. I sincerely believe that more small business owners would be able to afford health care coverage if provided the appropriate tax incentives. I do not understand why the tax code discriminates against the self-employed. We are the ones that need the most help in being able to provide health care coverage for ourselves and our employees. If we cannot take any deductions, our ability to provide coverage, at all, is severely hampered.

I understand this deduction was established in the Tax Reform Act of 1986 for a three-year period. NARI members have actively pursued the continuance of this deduction every year since 1989, when it was first set to expire. We've been fortunate enough to extend the deduction until last year. It is time this deduction was made permanent and increased to 100 percent. While I realize that tax deductions cost the U.S. Treasury money, so does the rising cost of Medicare and Medicaid for those people who require care and have no insurance. Encouraging greater employer-provided coverage through this tax incentive may end up saving the government money. Equal treatment for all types of business organizations,

large and small, will go a long way in reducing the number of uninsured in this country. I think that is a goal everyone can agree on.

I understand there is growing Congressional support for the permanent extension and gradual expansion of this deduction. On behalf of the 6,000 NARI members companies, I soundly applaud those efforts. Extension and expansion of the deduction makes sense for the following reasons:

1. It is a matter of equity and common sense. There is no practical argument for the current distinction between the treatment of C corporations, which enjoy one-hundred (100) percent deductibility, and S corporations and the self-employed, who no longer enjoy even a twenty-five (25) percent deduction.
2. Reinstating the twenty-five (25) percent deduction and increasing it to one-hundred (100) percent will reduce the number of uninsured and ease the government burden of caring for these individuals.

3. Health care insurance is a significant cost to small business, one that is often priced out of the range of affordability. A complete deduction and cost controls will bring it back into the realm of possibility for many that have had to drop coverage.
4. Enhancing this deduction will help many people. According to a study by the Employment Benefits Research institute, nearly a quarter of small business owners have no health insurance and half of all the uninsured are either self-employed or work for small firms. A complete tax deduction for health insurance is a strong incentive for small businesses to provide such an important employee benefit.

I appreciate the concern of this Committee and truly hope that immediate action is taken to restore the deduction retroactively for 1994 and that serious thought be given to expansion of the deduction to one-hundred (100) percent.

Again, I thank you Madam Chairman, for inviting me to appear before you and your committee today to bear witness to the need for this positive legislation. I am willing to answer any questions I can.

Respectfully Submitted,

Jeanie Morrissette  
Homestead Construction Co., Inc.  
3909 Annandale Road  
Annandale, VA 22203  
703/642-2366

*NARI is a not-for-profit trade association with nearly 6,000 member companies nationwide, representing over 40,000 remodeling industry professionals. NARI members are primarily residential home improvement contractors, and include national manufacturers and distributors of home improvement products and services.*

*Residential remodeling constitutes a \$100 billion industry that has grown over 130 percent in the last ten years. With over 50 years of experience, NARI is committed to enhancing the professionalism of the remodeling industry and serving as an ally to homeowners. NARI is dedicated to the growth and betterment of the remodeling industry and related small businesses. For more information about NARI, contact Patti Burgio, director of government affairs, NARI, 4301 North Fairfax Drive, Suite 310, Arlington, VA 22203, 703/276-7600.*

STATEMENT  
on  
HEALTH INSURANCE DEDUCTION  
before the  
HOUSE COMMITTEE ON SMALL BUSINESS  
for the  
U.S. CHAMBER OF COMMERCE  
by  
Lisa M. Sprague  
January 20, 1995

Chairman Meyers and members of the Committee, my name is Lisa Sprague, and I am the Manager of Employee Benefits Policy for the U.S. Chamber of Commerce. The Chamber is the world's largest business federation, representing 215,000 businesses (96 percent with fewer than 100 employees and 71 percent with fewer than ten), 3,000 state and local chambers of commerce, 1,200 trade and professional associations, and 72 American Chambers of Commerce abroad. We appreciate the opportunity to appear before this Committee to comment on the issue of health insurance deductibility for the self-employed.

Few issues are as clear-cut and convincing as this one. In fact, restoration of the 25 percent health insurance deduction is a top legislative priority for the Chamber. From our surveys to telephone calls and meetings, our members have indicated strong support on this issue.

Clearly, the U.S. business community has been the driving force in pushing reforms to our health care delivery systems and slowing the rate of increase in health care expenses. Today, we know that the U.S. business community provides health insurance for more than 85 percent of those Americans who are insured. As the engine of the U.S. economy, small businesses -- including the self-employed -- have played a key role in innovations and economies that have been realized. Yet the self-employed continue to be denied basic fair treatment when it comes to the issue of health insurance deductibility. That is why your hearing today is so important: to assist in efforts to get Congress moving quickly in rectifying this injustice.



While the Chamber's membership is greatly diverse, and at times this can result in the Chamber's having to choose varying priorities within a given legislative issue, we have yet to hear from a single constituency, or indeed a single member, a suggestion that equity in the deductibility of health insurance should not be a top priority for the Chamber.

Among the health reform measures we continue to support, full deductibility of health insurance for unincorporated businesses and the self-employed is indispensable. Sound tax policy dictates full deductibility of premium or self-insurance costs as ordinary and necessary business expenses. There is no valid tax policy reason for treating the smallest businesses any differently.

Since 1986, self-employed persons have been permitted to deduct 25 percent of amounts paid for health insurance for the individual, his or her spouse, and dependents of employees. This provision was never written permanently into the tax code, but was repeatedly extended -- until December 31, 1993, when it was allowed to lapse. Congress failed to renew it in 1994. Ironically, the one measurable result of the health reform debate that dominated the year was that the most vulnerable of those who provide health insurance were left in worse straits than before fervent discussion of expanding coverage began. The Chamber calls on Congress to restore the 25 percent deduction for 1994, and to act quickly enough that self-employed filers may reflect it in their 1994 tax filings.

To be sure, restoration of the 25 percent deduction is no more than a quarter of a loaf. What is really needed is legislation to permit 100 percent deduction of health insurance costs. The Chamber urges this Committee to work to enact full deductibility in 1995. Recognizing that the major obstacle to such action is its cost in tax revenues, the Chamber would accept a phased-in approach to 100 percent deductibility. What it cannot accept is that the smallest businesses, frequently new and often struggling, should be denied a measure of security granted to larger businesses.

The U.S. Chamber of Commerce wishes to commend you and the Committee for holding a hearing on an issue that has been a thorn in the side of the nation's smallest

businesses for many years: their inability to deduct the full cost of their health insurance, and the inequity inherent in being denied an advantage granted to their incorporated fellows. The Chamber looks forward to working with the Committee toward a goal of such vital importance to all of us.

### The 25% Medical Insurance Deduction for the Self-Employed

by: Betty Kohls Stehman, CIA  
 President and CEO, Entrepreneurial Financial Services, Inc.  
 National Director and Chief Financial Officer, American  
 Association of Home-Based Businesses  
 Recently applied for CPA license in the state of Maryland

The 25% self-employed medical insurance deduction expired on December 31, 1993. The effect of this missing deduction is to have the self-employed pay more in taxes when they already carry a heavy burden in the United States Taxation system. Just how big a problem is this?

According to the IRS statistics for 1992, 21.3 million business tax returns were filed. The breakdown of these returns is as follows:

Sole Proprietorships	15.10 million	70.9%
Partnerships	1.60 million	7.5%
Small Corporations	4.48 million	21.0%
Large Corporations	.02 million	.6%

Of the 21.3 million businesses, 5.7 million or 26.8%, are large enough to have employees. From these statistics one can conclude that approximately 15.6 million businesses are one-person shops or family run businesses.

In the IRS Code, Section 162 is titled ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS. The tax code in Sec. 162 begins with "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ." All forms of business entities are included in this section because business entities pay taxes either at the corporate level or at the shareholder/partner/individual level. C Corporations are allowed to deduct 100% of the medical insurance premiums and expenses that they incur for their employees which also includes the owners of the corporation or its five top officers. Based on the statistics above, only 21.6% of all business entities get the 100% deduction. Sub-Chapter S corporations are included in this 21.6% figure and their medical insurance premiums and expenses are passed through to the individual shareholders. Thus, they do not receive the 100% deductibility of their medical insurance costs. Although I was unable to find out how many Sub-S tax returns are in the corporate numbers above, I believe we can safely conclude that less than 1 in 5 businesses can deduct 100% of their medical insurance premiums and expenses.

What level of deductibility do 80% of the businesses receive for their medical insurance premiums and expenses? Under the pre-

January 1, 1994 tax provision, 25% of the medical insurance premium expense was totally deductible. The remaining 75% is first subjected to the 7.5% Personal Adjusted Gross Income exclusion that individuals are not allowed to deduct. Since income levels can be any amount, it is not possible to state in dollar terms how much money is lost in the medical insurance premium deduction at the individually taxed business entity level. It can be said that the maximum amount that could be deducted under the old laws is 67.5%. Thus, 80% of the businesses only receive a partial deduction for their medical insurance premium expenses.

The above information for 80% of the businesses only concerns the medical insurance premiums. Yet, there are other medical insurance expenses that only 20% of the businesses can deduct 100% of the cost 100% of the time; the other 80% of the businesses cannot deduct this same type of expenses 100% of the time for 100% of the amount spent. While we do not have information concerning the dollars involved in this issue, we can say that 80% of the business entities are not entitled to the same level of deductions for medical insurance expenses that large corporations are entitled to. We do know that, at a minimum, 80% of the business entities lose at least 7.5% of their medical insurance expenses forever. The reason the 7.5% dollar amount is lost forever is that there are no carryforward or carryback provisions for this type of deduction in the individual tax code which is where these businesses are taxed.

#### Suggestions for law changes

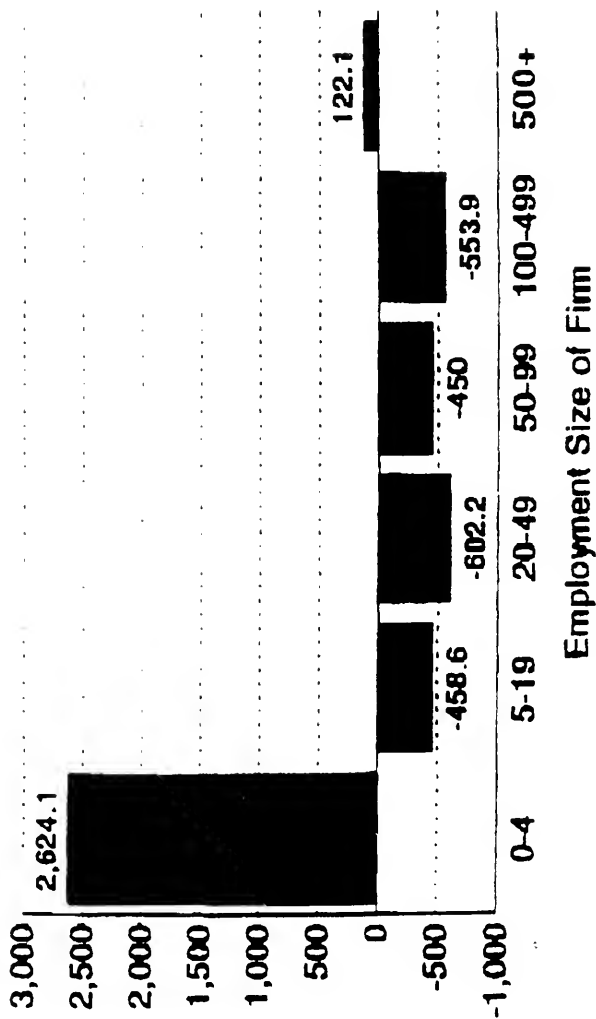
In order to foster equity between all business entities, the tax code needs to treat all business entities in the same manner. As quoted in my third paragraph, the present code states that ALL necessary and ordinary expenses should be deductible for individuals and corporations. At the present time, only C corporations are allowed to deduct all necessary and ordinary expenses incurred in their trade or business. Since the maximum percentage of entities which are allowed to do this is 21.6%, 78.4% of the business entities have been singled out to carry an additional burden in the tax system. The business entities which range in size from 0-4 employees created 2.6 million jobs during the time period of 1989-1991. Large companies (500+ employees) created 122 thousand jobs during this same time. All other business size classes lost jobs during this time. The constant downsizing of large corporations continues to place a heavy burden on the small business sector in terms of tax revenue, job creation, and the associated business expenses. Medical insurance premiums and expenses are some of the associated business expenses that increase with job creation. Without full deductibility of these medical costs, small business may not be able to offer medical benefits to their employees and/or their families/dependents. The additional problem of uninsured people spills over into other areas of our

society. Thus, it is essential that the medical insurance premium and expenses deduction be equalized for all business entities, regardless of how they are taxed.

Resource Material

1. The Internal Revenue Code as amended through August 15, 1993
2. The White House Conference on Small Business Issue Handbook.
3. Small Business Administration resource material.
4. Hands-on experience with home-based and small business.

# Net Job Creation in All Industries by Employment Size of Firm, 1989-1991 (in Thousands)



TESTIMONY OF CRAIG WILLETT, CPA  
OWNER, WILLETT AND ASSOCIATES  
ON BEHALF OF THE  
NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB)

Before: Committee on Small Business  
Date: January 20, 1995  
Subject: Self-Employed Health Insurance Deductibility

Thank you, Madam Chairman. My name is Craig Willett, and I am a small business owner and CPA from Provo, Utah. I am submitting this testimony on behalf of the National Federation of Independent Business (NFIB). NFIB is the nation's largest small business advocacy organization, representing over 600,000 small business owners from all fifty states. The typical NFIB member has five employees and has \$250,000 a year in gross annual sales. NFIB sets its public policy positions through regular polling of the membership.

I want to take this opportunity to thank you for inviting NFIB to participate in this hearing today, and also to commend you for bringing attention and urgency to the issue of health insurance deductibility for self-employed Americans -- sole proprietorships, partnerships, and subchapter S corporations. I am very hopeful that this hearing will begin a process by which a major unfairness in our tax code will be eliminated.

Attaining full tax deductibility for the self-employed has been a top priority for NFIB for many years. Eighty-two percent of NFIB members support full deductibility of health insurance premiums, according to a 1993 survey. Health insurance deductibility has also been designated a top priority in several state conferences leading up to the 1995 White House Conference on Small Business.

Approximately half of our more than 600,000 members own unincorporated businesses. In fact, a majority of all businesses in this country are self-employed. Self-employed businesses are the cradle of job creation and the American dream: the newer and smaller the business, the more likely it is to be unincorporated. These self-employed business owners are the very people whose firms need to start, survive, and grow in order to create the jobs of the future. These are often people with very little cash, a good idea and talent -- struggling to make it work. And once they do make it work, they are a major part of the group that creates nearly all new jobs in our economy. Government data shows that small business has created two of every three net new jobs since the 1970s, and a substantial majority of those jobs were created in the smallest firms - - those with fewer than five employees. Firms of this size, which constitute 60% of all employers in this country, tend to be unincorporated.

These unincorporated business owners -- some with employees, some working on their own -- experience the worst of all possible worlds in the health insurance marketplace: an insufficient product for a high price and denial of the same incentives and tax treatment enjoyed by big business.



The High Cost of Health Insurance

Self-employed business owners often pay approximately 30 percent more than larger companies for similar benefits because of higher administrative costs. In addition, they often pay another 30 percent in premiums because of costly state mandates for specific types of insurance coverage, which prevent self-employed business owners from shopping for only the basic care that they and their employees might need. Larger firms that self insure, by contrast, are not subject to these costly mandates. The self-employed usually lack access to cost-saving managed care arrangements because of a reluctance by insurers to create and market them in small towns and rural areas. Additionally, a small, unincorporated firm is far more likely than others to feel the painful brunt - both economic and emotional - of the pre-existing condition exclusion or, when an employee gets sick, the 20 percent to 300 percent premium hike or sudden cancellation of insurance. Insurance companies are much more likely to require exclusions, raise premiums or cancel policies to shield themselves from risk when insuring a small firm or a one person firm rather than a large business.

All of this accounts for a trend found in NFIB Education Foundation studies that began in 1986. In that year, small business owners -- both self-employed and incorporated -- for the first time identified the cost of health insurance as their number one problem in a study entitled *Problems and Priorities*. That trend has continued ever since, with the cost of health insurance proving to be twice as critical a problem as the number two problem (federal taxes on business income) in a follow up study published in 1992. With health insurance premiums still growing faster than the rate of inflation today, this problem has not abated.

### No Deductibility

On top of all this, self-employed Americans cannot deduct any of their health insurance premiums. C corporations have a permanent, 100 percent deduction; self-employed business owners have none. The self-employed had a 25 percent deduction until December 31, 1993, when it expired. The 103rd Congress adjourned without renewing the deduction for 1994, (despite your great efforts and those of your bipartisan cosponsors). This means that self-employed business owners will experience a tax increase on their 1994 returns -- unless Congress acts before April 15.

Using Joint Tax Committee cost estimates and Foster-Higgins survey data on premiums, NFIB estimates that approximately 1.4 million self-employed business owners will have their taxes go up if the 25 percent deduction is not retroactively renewed for 1994. NFIB strongly supports your bill, Madam Chairman, H.R. 442, which would prevent this tax increase.

Even before the 25 percent deduction expired, self-employed business owners were buying health insurance on a tax policy playing field that was vastly uneven. The difference between a 25 percent deduction for the self-employed and a 100 percent deduction for C corporations is terribly unfair and arbitrary. But it is not only a philosophical matter of fairness; it is a matter of dollars and cents. Under current law, it would cost a sole proprietor buying the exact same health insurance policy from the exact same insurance company as the owner of a C corporation substantially more in after tax dollars because of the deductibility gap.

### Recommendation

NFIB strongly urges this committee and this Congress to end the health insurance tax deductibility status quo and address the tax fairness issue head on. Specifically, NFIB urges the Congress to retroactively restore the 25 percent deduction to the self-employed and to send a clear signal that business as usual is a thing of the past by increasing the deduction to at least 50 percent and making a commitment to reaching parity as soon as fiscally possible.

Ending the status quo -- setting a course toward 100 percent deductibility -- accomplishes the following:

(1) **Parity.** Full deductibility for the self-employed would end the idea that an executive for a Fortune 500 company can get a full deduction for a gold plated health insurance policy but a self-employed business owner receives no deduction at all -- solely because of the way the business is legally organized.

Some may argue that limited deductibility for the self-employed should be preserved at some level in an effort to make Americans more sensitive to the actual cost of their health care, thereby making the market place more competitive. NFIB believes that concerns about the impact of the tax code on health care cost sensitivity are legitimate. However, any approach to this issue which says that limited deductibility is good policy for the self-employed but not simultaneously for C corporations is unfair and unacceptable.

**(2) Incentive for the self-employed to purchase health insurance for themselves and their families.** Self-employed Americans are one of the largest groups of uninsured citizens. There are nearly three million self-employed Americans without health insurance. The 25 percent deduction is a small but meaningful incentive for unincorporated business owners to purchase health insurance for themselves and their families. If this group of business owners were given the 100 percent deduction, many more would purchase insurance, substantially reducing the number of uninsured Americans in this country. Consider the following example:

A self-employed caterer purchases a health insurance plan for \$3,781 per year. [The actual amount would actually be less or more depending on whether the caterer was purchasing an individual or a family policy; \$3,781 was the average per person premium in a Foster-Higgins survey of 1993 premiums. A self-employed person would usually pay more than this average because of many of the disadvantages of buying health insurance individually.] The caterer is in the 28 percent tax bracket.

**After-tax savings from a 25 percent deduction: \$264.67**

**After-tax savings from a 100 percent deduction: \$1058.68**

Most self-employed business owners survive on tight margins -- they keep the business afloat on cash flow, not profit. The typical NFIB member makes less than \$40,000 a year. Affordability is the most important factor to small business owners when deciding whether to buy health insurance. To people in this position, the savings shown in the example above can make a real difference when making a decision on whether to buy an important, but very expensive product.

**(3) Incentive for the self-employed to purchase health insurance for their employees.**

NFIB strongly believes that full deductibility for the self-employed would also reduce the number of uninsured among the employees of the self-employed. Under current law, a self-employed business owners find themselves in the peculiar position of being permitted to deduct the health insurance costs of their employees, but not their own premiums. If they have no incentive to purchase health insurance for themselves, they are far less likely to consider buying it for their employees. Full deductibility would change that.

**(4) Tax Fairness: Ending politics as usual.** The 25 percent deduction has been temporarily extended from year to year since it was first enacted in 1986. Because of its substantial bipartisan popularity, it has repeatedly been held hostage in previous Congresses to other, typically very unpopular causes like the tax increases in 1990 and 1993, as well as the Clinton health care plan last year. Again, restoring the 25 percent deduction and moving toward 100 percent would shatter a status quo in which the self-employed are used as a political football.

---

Self-Employed Health Insurance Deduction: A History

<b>1986-1989:</b>	The self-employed were first given 25 percent deductibility as part of the Tax Reform Act of 1986.
<b>1989:</b>	The Omnibus Budget Reconciliation Act of 1989 extended the deduction for nine months (for taxable years beginning before October 1, 1990.)
<b>1990:</b>	25 percent deductibility was extended through 1991.
<b>1991:</b>	25 percent deductibility was extended through June 30, 1992.
<b>1992:</b>	On June 30, 1992, 25 percent deductibility expired.
<b>1993:</b>	25 percent deductibility was included in Omnibus Budget Reconciliation Act of 1993 and applied retroactively from July 1, 1992, to December 31, 1993. (The deduction was limited if the individual or his or her spouse was eligible to participate in an employer-paid health plan.)
<b>1994:</b>	Self-employed deductibility no longer exists.

---

(5) **Health care reform: The first step.** The health care debate of the 103rd Congress ended in acrimony and gridlock. The deductibility issue gives the new Congress an opportunity to swiftly set a new tone for the health care debate: taking incremental steps on which most people agree to improve the system. The deduction for the self-employed is a great place to start: a reform with wide bipartisan support that would reduce the number of uninsured and deliver some much needed relief and fairness to others struggling to stay insured.

### Conclusion

Again, NFIB urges Congress to do the following:

(1) Restore the 25 percent deduction retroactively for 1994 and increase it to 50 percent as a signal to every self-employed business owner that the status quo on this issue will no longer be tolerated.

(2) Move toward a permanent 100 percent deduction for the self-employed as soon as fiscally possible.

NFIB hopes that the Small Business Committee will champion the cause of the self-employed health insurance deduction. Madam Chairman, we would like to again express our appreciation for your leadership on this important issue in this Congress and previous Congresses. We strongly support your bill, H.R. 442. Self-employed business owners are calling out for fairness and stand ready to help you and your colleagues achieve it in 1995.

Thank you.

**TAX DIVISION  
OF THE  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS SUBMITTED FOR  
THE WRITTEN RECORD**

**HOUSE COMMITTEE ON SMALL BUSINESS  
HEARING ON DEDUCTIBILITY OF HEALTH INSURANCE PREMIUMS  
FOR THE SELF-EMPLOYED**

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
1455 PENNSYLVANIA AVENUE, NW, SUITE 400  
WASHINGTON, DC 20004  
(202) 737-6600**



The American Institute of Certified Public Accountants (AICPA) is the national, professional organization of CPAs comprised of more than 320,000 members who advise clients on federal, state and international tax matters as well as prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-size businesses, as well as America's major businesses, including multi-national corporations. Many serve businesses as employees. It is from this base of experience that we offer our comments on the tax treatment of health insurance costs of self-employed individuals.

The decision in 1994 to postpone consideration of health care reform legislation has resulted, among other things, in the loss of a deduction by self-employed individuals for any health insurance premiums they have paid in that year. As part of the 1993 Omnibus Budget Reconciliation Act, when a number of other "expired provisions" were retroactively re-enacted (targeted jobs tax credit, low-income housing credit, employer-provided education and training expenses, etc.) and allowed to remain in the law past the end of 1993, the deduction for 25 percent of self-employed insurance premiums was terminated at the end of the calendar 1993. The committee reports noted that this provision should be considered in conjunction with forthcoming health care reform (as indeed it was, in virtually all the health care bills proposed during 1994).

Since, however, there were no health care changes in 1994, there was also no extension of the deduction for self-employed health insurance. This is a highly unfortunate result, and puts a significant penalty on the health costs of those who operate as proprietors, partners, or S corporation shareholder/employees, vis-a-vis those who are employees of C corporations.

Pending whatever changes are made to health care legislation in the future, we think it critical that Congress re-establish the right of self-employed persons to receive even that limited deductibility for health insurance costs that they enjoyed before 1994. We do recognize that this provision, on a stand-alone basis, is a revenue loser for the government. Nonetheless, there remains a major issue of fairness for a significant part of the business community, and we would urge your attention to this matter.

As an organization that values simpler approaches to tax legislation, we would greatly prefer to see action taken immediately, before the bulk of 1994 returns have been filed, rather than the added complexity of amended 1994 returns and refund claims that even a minor delay will cause. Still, we believe the self-employed business person has now – even with the best of congressional intentions – been further disadvantaged with respect to the cost of health care, and is entitled to a restoration of the deduction for the current year.

We appreciate your consideration of our views.







ISBN 0-16-047327-6



9 780160 473272